

County of San Bernardino

**Auditor-Controller/Treasurer/Tax Collector
Internal Audits Section**

District Financial Services: Payment Auditing Process



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SUBJECT: District Financial Services (Payment Auditing Process) FY09-14

In compliance with Article V, Section 6, of the San Bernardino County Charter and County Policy 05-20 entitled Internal Operational Auditing, we have completed an audit of the San Bernardino County Superintendent of Schools District Financial Services' (DFS) payment auditing process for the period of July 1, 2008 through June 30, 2014. The primary objective of the audit was to determine the effectiveness of the audit process in place over the processing of school districts' claims. We conducted our audit in accordance with the International Standards for the Professional Practice of Internal Auditing established by the Institute of Internal Auditors.

Out of the 81 transactions we reviewed that were audited by DFS over a period of 6 years, we found only 3 exceptions or an error rate of 3.7%. However, out of the 686 transactions we reviewed that were not audited by DFS, we found 84 exceptions or an error rate of 12.2%. The audit process appears to be generally effective, however increased audit levels should be considered. We also identified several procedures and practices that could be improved. We have listed these areas for improvement in the Audit Findings and Recommendations section of this report.

We sent a draft report to the Department on August 25, 2015 and discussed our observations with management on September 4, 2015 and January 21, 2016. The Department's responses to our recommendations are included in this report.

We would like to express our appreciation to the personnel at the District Financial Services who assisted and cooperated with us during this engagement.

Respectfully submitted,

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District Financial Services: Payment Auditing Process

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Executive Summary



The tables below summarize the prior year and current year audit findings and recommendations for this audit engagement. For further discussion, refer to our *Audit Findings and Recommendations* section of this report.

Prior Finding No.	Prior Year Findings	Status for FY09-FY14						Page No.
		FY 09	FY 10	FY 11	FY 12	FY 13	FY 14	
1	Support for transactions could not be found at DFS or school districts.	✓	✓	✓	✓	✓	✓	4
2	Internal controls over signature authorization forms could be improved.						✓	5
3	Invoices could not be compared to purchase orders or contracts.	✓						6
4	Payments were made without adequate receiving documentation.	✓				✓		8
5	Change order elements were not present.	No additional exceptions noted in current audit.						9
6	Payments were made without an original or certified copy of an original invoice.	✓	✓	✓	✓	✓	✓	9
7	Remaining balances were not indicated on open purchase orders.	No additional exceptions noted in current audit.						10
8	School district's name was not indicated on invoice.	No additional exceptions noted in current audit.						10
9	An incorrect object code was used.				✓		✓	11
10	Internal controls over credit cards could be improved.					✓		12
11	Internal controls over Child Development Services payments could be improved.	No longer applicable as these payments are no longer processed by DFS.						12
12	Tax could not be verified as correctly charged.	No additional exceptions noted in current audit.						13
13	Document in lieu of purchase order did not have an explanation as required.	No additional exceptions noted in current audit.						13
14	Finance and late charges were paid.	No additional exceptions noted in current audit.						13

✓ = Finding occurred

Executive Summary



Finding No.	Current Findings and Recommendations	Page No.
1	DFS Audit Manual has not been updated and distributed to the districts on a regular basis.	14
	Ensure the Audit Manual is revised, approved, and distributed.	
2	Internal controls over travel claims could be improved.	14
	Verify the claimant's reimbursement amount agrees with the district's policy.	
3	DFS's audit procedures are not being performed for Building Fund payments.	15
	Review the bond election purpose as stated in the official statement prior to authorizing payments from the Building Fund.	
4	DFS's Public Works Audit Manual does not include audit procedures for districts that operate under the Uniform Public Construction Cost Accounting Act (ACT).	16
	Create and distribute audit procedures related to the ACT.	



Background

District Financial Services (DFS) is an external services department of the San Bernardino County Superintendent of Schools responsible for the processing of financial transactions of K-12 school districts, community college districts, dependent charter schools, regional occupational program districts, joint powers authorities, and the County Schools' office. DFS audits and processes commercial vendor payments, payroll, interfund transfers, journal entries, public works payments, and other various transactions. DFS also performs statutory examination and approval functions on behalf of both the County Superintendent of Schools and the County Auditor-Controller.

DFS administers audit parameters for local educational agencies (LEA) in the County and performs audits of selected payments and contracts. DFS has created an audit manual to document the objectives and general audit procedures to be performed on warrant packages submitted to DFS by districts. DFS has also drafted public works audit guidelines to document standardized procedures for construction related transactions and bidding procedures.

Scope and Objective

We audited school district transactions for the period of July 1, 2008 through June 30, 2014. The objective of the audit was to test and evaluate transactions to determine the operating effectiveness of DFS' audit process over the processing of the school districts' claims.

Methodology

The audit included interviewing DFS staff directly involved in the payment auditing process to gain an overall understanding of the operation, reviewing DFS' policies and procedures, examining system generated reports, selecting a statistically selected sample of school districts' transactions, and examining original source documents maintained at DFS and/or the school districts.



AUDIT FINDINGS AND RECOMMENDATIONS

As a result of our audit procedures, the following identifies the status of the prior year findings. These are located under the heading "Status of Prior Year's Findings and Recommendations". The current year's findings are located under the heading "Current Findings and Recommendations".

Status of Prior Year's Findings and Recommendations – Audit Report Dated October 14, 2009

Prior Finding 1: Support for transactions could not be found at District Financial Services and at school districts.

Recommendations

Keep originals, or certified originals, of all documentation received on file at District Financial Services and require that districts also retain support. Ensure that procedures require all documentation to be present, complete, and accurate before making payment and that these procedures are followed for all payments. Establish and enforce written policies and procedures regarding the filing and safeguarding of documentation.

Status for FY09-14

Our sample of 686 transactions identified 13 instances where supporting documentation was missing at the districts. District personnel were allowed additional time to locate the documentation, but were still unable find the appropriate back-up documentation to support the expenditure. It could not be determined whether supporting documentation was misplaced or not obtained. Without supporting documentation, the likelihood of inaccurate or unauthorized expenditures is increased. These instances occurred in every fiscal year examined, however, none of these transactions were selected for audit by DFS.

Further Recommendations

DFS should remind the districts to ensure that a warrant packet is complete and available for audit. In addition, DFS should recommend districts establish and enforce written policies and procedures regarding the filing and safeguarding of documentation to help provide an audit trail.



Management's Response

We concur with this finding, and we will continue to remind districts to retain complete payment documentation, even for payments not selected for audit by DFS. We will continue to recommend that districts establish and enforce written policies and procedures relative to document retention.

Auditor's Response

DFS' response addresses planned action to prevent reoccurrence of this finding.

Prior Finding 2: Internal controls over signature authorization forms could be improved.

Recommendations

Establish and enforce written policies and procedures regarding the filing, recording, and updating of all signature authorization forms and the corresponding Authorized Signature Listing (Listing). Include instructions in the policies indicating that if there are at least 2 persons authorized by County Form 1, then no person should sign their own authorization forms. Also, specify the purpose of each form to be used in the policies. Audit purchase orders against the current, updated Listing to ensure that signatures are authorized. Return payments without this authorized signature to districts for an authorized agent to sign, or require that the proper forms be submitted.

Status for FY09-FY14

The following conditions were noted as a result of the current year audit test work of the Listing, which is maintained by DFS:

- One instance of a County Form No. 1 – *Certification of Board Minutes* being signed by an unauthorized employee
- Fifteen instances where the access authorized in the County Forms was not accurately reflected in the ASL database.

DFS does not have written procedures for updating the ASL database and filing forms. The database is used by DFS during their audit process. Reliance on the authorized signature list during DFS' audit process could lead to a payment approved by an unauthorized person.



Further Recommendation

DFS should establish and distribute written policies and procedures regarding the County Signature Authorization Forms and the addition/modification of the ASL database.

Management's Response

While we concur with this finding and agree that we need to memorialize our internal procedures in writing for our staff, it should be noted that the fifteen instances of inaccurately-reflected signature authorizations were not a case of unauthorized employees being allowed wholesale access to transactions or payments. In those fifteen cases, authorized employees' access was listed as journal entry authorization, rather than the specific type of journal entry, i.e., payroll or accounts payable. It should also be noted that the audit of the Authorized Signature Listing is not merely a sampling, but a complete audit of 6,230 individual attributes, resulting in a 99.99% accuracy rate.

Auditor's Response

By listing employees on the ASL as authorized for all journal entries instead of restricting them to only the specific types authorized by the district, they may be improperly allowed access to transactions or payments. The ASL is audited completely as one incorrect listing can weaken the controls over all payments. DFS' response addresses planned action to prevent reoccurrence of this finding.

Prior Finding 3: Invoices could not be compared to purchase orders or contracts.

Recommendations

Ensure that purchase orders or contracts are present for all applicable expenditures and that there is documentation of proper authorization and purchases on the invoice can easily be identified and compared back to the purchase order. Do not process payment on an invoice that cannot be compared to its respective purchase order or contract and verified as an allowable expense.

Status for FY09-14

Our sample of 686 transactions identified one instance in 2009 where the vendor's name was not evident on the invoice or other back-up documentation.



Without a vendor name on an invoice, it cannot be verified as an allowable expenditure.

Our audit also identified one instance in 2009 of a district stating the value of \$1 on a purchase order whose terms and conditions indicated a much higher value. The district described the terms, conditions and dollar value in the purchase order, but erroneously recorded \$1 as the total amount of the purchase order. Recording a lower amount than the actual amount of the purchase may cause the district's available budget to be overstated, and possibly circumvent controls in place to prevent budget overruns.

Lastly, our sample identified one instance in 2009 where the district received a shipment that included more items than were approved in the original purchase order. The district paid the invoice for the greater amount, including the extra items. Unauthorized expenditures made on purchase orders or contracts may not be detected if invoices are not compared to purchase orders and disallowed if they do not agree.

These transactions were not audited by DFS.

Further Recommendation

We recommend DFS continue to relay to the districts the importance of comparing invoices to their respective purchase orders for budget and authorization purposes.

Management's Response

The last instance of this finding was in 2009, and we will continue to stress the importance of comparing invoices to their respective purchase orders.

Auditor's Response

DFS' response addresses planned action to prevent reoccurrence of this finding.



Prior Finding 4: Payments were made without adequate receiving documentation.

Recommendations

Require all payments to include the proper receiving documentation with a signature of at least the first initial and full last name of the signer, initials okay for centralized receiving, as well as the date the goods were received. Verify this documentation prior to processing payment. Ensure that districts are aware of the requirements in documenting receipt of goods and services and invoice approval.

Status for FY09-FY14

Our sample of 686 transactions identified 6 instances, 5 in 2009 and 1 in 2013, where an indication of receipt of goods or services was not evident on the invoices or other back-up documentation and three instances in 2009 where a signature was present, but the receiving date was not indicated. Two of these instances were audited by DFS. Without proper documentation that goods or services were received, there is increased likelihood that payment will be made for goods or services not authorized or received.

Further Recommendation

Reiterate to the districts the requirements in documenting both a signature and a date for the receipt of goods and services as this documents the receipt of goods and services.

Management's Response

We concur with this finding from 2009 and 2013, and we will continue to reiterate to the districts the requirement to include both a signature and a date for the receipt of goods and services.

Auditor's Response

DFS' response addresses planned action to prevent reoccurrence of this finding.



Prior Finding 5: Change order elements were not present.

Recommendations

Do not process any payment for which a properly authorized purchase or change order, when applicable, for payment is not documented. Ensure that changes to public works projects are in compliance with the applicable codes and governing bodies, and do not process payment until this compliance is documented.

Status for FY09-FY14

No additional exceptions of this type were identified as a result of the current year audit test work.

Prior Finding 6: Payments were made without an authorized original or certified copy of an original invoice.

Recommendations

Increase invoice auditing to ensure that an original invoice is obtained prior to processing payment. If a copy is submitted, ensure that the copy is certified as an original invoice with a signature of district personnel. If a copy is not certified, request a certified copy prior to processing payment. Ensure that districts are aware of the requirements in certifying an invoice as original.

Status for FY09-FY14

Our sample of 686 transactions identified 39 instances, from three districts, where payment was made on a copy of an invoice that lacked the certification from district personnel as original. These instances occurred in every fiscal year examined, however, none of these were selected for audit by DFS. If original or certified copies of original invoices are not obtained prior to payment, unauthorized expenditures may be made or duplicate copies of invoices may be submitted for payment. Certifying an invoice as original helps to prevent the District from duplicating payments or paying for unauthorized goods or services.

Further Recommendation

DFS should ensure that all districts are aware of the requirement to make all payments on original or certified copies.



Management's Response

We concur with this finding and will continue to reiterate the requirement to make all payments on original or certified copies.

Auditor's Response

DFS' response addresses planned action to prevent reoccurrence of this finding.

Prior Finding 7: Remaining balances were not indicated on open purchase orders.

Recommendations

Increase purchase order auditing on open purchase orders to require all previous payments and remaining balances to be indicated on all open purchase orders. Do not process payment until this information has been verified and documented by the District.

Status for FY09-FY14

No additional exceptions of this type were identified as a result of the current year audit test work.

Prior Finding 8: School district's name was not indicated on invoice.

Recommendations

Do not process payment on an invoice that does not have the school district's name on it. Return all invoices without district's name to the district and instruct them to request a revised invoice with the district's name.

Status for FY09-FY14

No additional exceptions of this type were identified as a result of the current year audit test work.



Prior Finding 9: An incorrect object code was used.

Recommendations

Distribute the California Standard Account Code Structure (SACS) list of object codes to all districts to ensure that the most current codes are in use. Review all documents received against this list to ensure that the most appropriate codes are being used and notify the districts when a more appropriate object code is available.

Status for FY09-FY14

Our sample of 686 transactions identified only 2 instances where the object code did not appear reasonable, one of which was an expenditure that should have been capitalized. These transactions occurred in FY12 and FY14, and neither of these transactions were audited by DFS. When district personnel use incorrect accounting codes, remaining budgets may be incorrectly stated, financial statements may be inaccurate, capital assets may be purchased without proper authorization and the listing of capitalized assets may be incomplete.

Further Recommendation

DFS should instruct District personnel to ensure that the item/service purchased is accurately classified in the appropriate object code according to the SACS and the district's account code structure. Using the correct object codes will help ensure district reports and the financial statements are accurately stated and spending does not exceed budget by category.

Management's Response

We concur with this finding and will continue to stress to the districts the importance of using the correct object code.

Auditor's Response

DFS' response addresses planned action to prevent reoccurrence of this finding.



Prior Finding 10: Internal controls over credit cards could be improved.

Recommendation

Ensure that districts are aware of District Financial Services' policies and procedures governing credit cards.

Status for FY09-FY14

Our sample of 686 transactions identified 3 transactions during fiscal year 2013 where either the authorized cardholder or the approving official's signatures were missing from the credit card statements. One of the three instances was audited by DFS. When credit card statements are processed without appropriate authorization, the risk of inappropriate or unauthorized use of the credit card increases.

Further Recommendation

DFS should remind districts of the importance of the procedures required for district issued credit cards including signing and dating the monthly statement and having an approving official also sign and date the statement to show evidence that charges were approved and allowable.

Management's Response

We concur with this finding and will continue to remind districts of the importance of following proper credit card procedures.

Auditor's Response

DFS' response addresses planned action to prevent reoccurrence of this finding.

Prior Finding 11: Internal controls over Child Development Services payments could be improved.

Recommendations

Implement a step in the auditing of the CDS payments to verify that separate signatures exist for the "Parent" and "Provider." Do not process payments for which there are not two separate signatures.



Status for FY09-FY14

This finding was no longer applicable as the CDS payments are no longer processed by DFS.

Prior Finding 12: Tax could not be verified as correctly charged.

Recommendations

Update the District Financial Services' audit manual to include proper instructions on auditing invoices for the correct amount of sales tax. When districts receive an invoice with an incorrect or unclear amount or rate of sales tax, the district should contact the vendor to obtain a revised invoice.

Status for FY09-FY14

No additional exceptions of this type were identified as a result of the current year audit test work.

Prior Finding 13: Document in lieu of purchase order did not have an explanation as required.

Recommendations

Ensure that documents for all districts and schools for which payments are processed by DFS have a representative sample of payments audited by DFS to ensure that all payments being processed are reasonable and allowable.

Status for FY09-FY14

No additional exceptions of this type were identified as a result of the current year audit test work.

Prior Finding 14: Finance and late charges were paid.

Recommendations

Require districts to pay the full balance on all credit card statements. Require the districts to send in credit card transactions for processing with enough time to get the payment turned around and sent out before late charges are assessed.

Status for FY09-FY14

No additional exceptions of this type were identified as a result of the current year audit test work.



Current Year Findings and Recommendations

Finding 1: DFS Audit Manual has not been updated and distributed to school districts on a regular basis.

The DFS Audit Manual provides DFS staff with documented, standardized audit procedures to allow consistent auditing of the local educational agency (LEA) payments and contracts. The manual also provides guidance to the districts on the requirements for payment processing. The DFS audit manual was last updated in 2004. The manual was reviewed and edited in 2014, but currently remains in draft form. Also, our audit identified many LEAs that were unaware of the DFS audit manual and requested a copy during our field visit. Without redistributing the audit manual, LEAs may not be aware of the standards and procedures required for payments, which may lead to a potential increase in unauthorized or improper payments.

Recommendation

We recommend that DFS revise and approve their audit manual on a regular basis and distribute the manual to all LEAs in the County. We further recommend that DFS hold a training for all LEA staff involved in purchasing and accounts payable when the latest manual is adopted. Communicating the audit requirements to the districts will help ensure a complete warrant package is submitted or maintained for audit and reduce the risk of unauthorized or improper payments being processed.

Management's Response

We concur with this finding; in fact, it was DFS that brought it to the attention of the auditors. We are already in the process of revising our audit manual and plan a detailed training for LEA staff when it is adopted.

Auditor's Response

DFS' response addresses planned action to prevent reoccurrence of this finding.

Finding 2: Internal controls over travel claims could be improved.

According to Education code 44032 and 87032, districts are authorized to incur actual and necessary expenses of any employee of the district while performing services of the district under direction of the Governing Board. According to the



DFS Audit Manual, districts may establish their own board-approved travel policy to stipulate specific requirements and rates.

Our sample of 686 transactions identified 3 instances of employees being reimbursed for meals in excess of the District's reimbursement policy. These instances occurred in fiscal years 2012, 2013 and 2014. The three instances occurred in three districts that had adopted their own district policy. The sample also identified 4 instances of employees reimbursed for an amount other than the districts' specified mileage rate. These instances occurred in fiscal years 2009, 2012, 2013 and 2014. In addition, the sample identified one instance of a travel claim in 2009 that was not calculated accurately. None of these were selected for audit by DFS.

When reimbursement amounts are not verified, calculated and compared against the district policy, claimants can be reimbursed an amount in excess of the amount requested.

Recommendations

DFS should instruct district personnel to verify the detailed breakdown of meals compared to the district's policy and only reimburse up to the allowable amount. Personnel should also verify that the proper mileage rate is used on the travel claim.

Management's Response

We concur with this finding and will continue to instruct districts to verify travel claims against their own policies.

Auditor's Response

DFS' response addresses planned action to prevent reoccurrence of this finding.

Finding 3: DFS audit procedures are not being performed for Building Fund payments.

The DFS Audit Manual includes audit procedures for the Building Fund (Fund 21) that include reviewing the bond election purpose and verifying that the expenditure complies with the bond election purpose.



DFS is not verifying whether the expenditure complies with the bond election purpose for payments made from the Building Fund. If the audit procedures established in the audit manual are not followed, the effectiveness of the audit process may be weakened. Also, bond proceeds may be expended for unallowable purposes.

Recommendation

We recommend that audit procedures are performed as stated in the DFS Audit Manual, and that DFS require a copy of the bond purpose from the district's official statement in the warrant packet as audit evidence.

Management's Response

DFS has not audited for "bond election purpose" for over ten years, and this specific requirement has already been removed from the DFS audit manual as revised. Many years ago it was determined that an audit clerk in DFS should not be responsible for such a judgment call and that a district's Bond Audit, External Audit, and Bond Oversight Committee provided sufficient oversight over "bond election purpose". All other audit parameters relating to construction payments/public works, including proper payment and performance bonds, legal bid procedures, authorized signatures, etc., remain in place. In the future, we may consider requiring the districts to sign a certification that the expenditure of bond funds complies with the bond election purpose.

Auditor's Response

We recommend that DFS work with the Auditor-Controller/Treasurer/Tax Collector's Office (ATC) to determine the level of auditing required as they are auditing on behalf of ATC. If it is decided that the audit clerks should not perform this audit procedure, mitigating controls should be implemented to reduce the risk to a level acceptable to DFS and ATC.

Finding 4: DFS' Public Works Audit Manual does not include audit procedures for districts that operate under the Uniform Public Construction Cost Accounting ACT.

The Uniform Public Construction Cost Accounting Act (Act) allows the governing body of each local agency by resolution to voluntarily elect to become a participating agency. Participating agencies benefit from an increased informal



bid limit. The informal bidding procedures are outlined in the Act for public works projects.

Many Districts in the County have voluntarily elected to participate in the Act. Consequently, more projects are initiated in a timely manner due to the informal bidding procedures allowed by the Act. The DFS Public Works Audit Manual does not include audit procedures specific to districts that operate under the Act. As a result, there is not a standard for which documents are required to be submitted to DFS by the participating districts for these projects. Furthermore, DFS does not request bidding documentation from the participating agencies for audit.

By not reviewing bid documentation on public works projects governed by the Act, the risks of bid circumvention, contractor favoritism or overpaying for projects are increased.

Recommendation

DFS should create and include audit procedures related to the ACT in the Public Works Audit Manual. The California State Controller's Cost Accounting Policies and Procedures Manual includes an accounting procedure review to outline requirements of the ACT for guidance. The revised manual should be distributed to the districts for their records.

Management's Response

We concur with this finding; in fact, DFS spoke first to the auditors about our need to create a chapter in our Public Works Audit Manual dedicated to the Uniform Public Construction Cost Accounting Act (Act). It should be noted that we do audit payments according to the provisions of the Act; although we do not request bid documentation due to the nature of the informal bid process and the possible variations in bid publication. In the future, DFS may start requiring the district to sign a certification that the informal bid process was conducted according to the provisions of the Act.

Auditor's Response

DFS' planned actions may correct the deficiencies in their Public Works Audit Manual related to the Uniform Public Construction Cost Accounting Act (Act). If needed, DFS can include language to allow flexibility in the possible variations used for bid procedures.